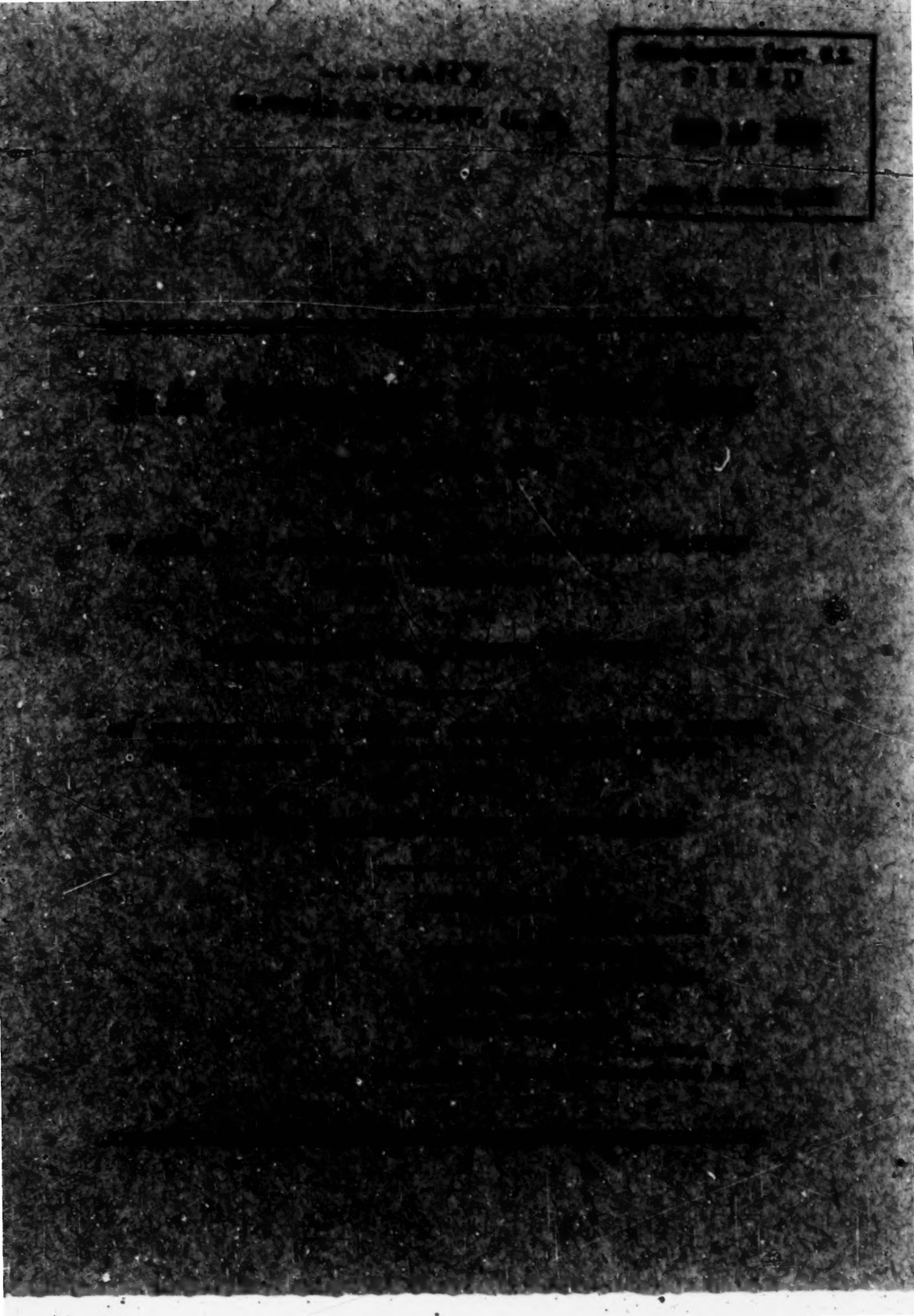

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 451

WALTER R. LAUDENSLAGER AND MARGUERITE LAUDENSLAGER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion (R. 14a–21a)[1] of the Tax Court are not officially reported. The opinion of the court of appeals (Pet. 1a–11a) is reported at 305 F. 2d 686.

JURISDICTION

The judgment of the court of appeals was entered on June 27, 1962 (Pet. 12a). The petition for a writ of certiorari was filed on September 21, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

[1] Record references are to the separately bound appendix to taxpayers' brief in the court of appeals.

QUESTION PRESENTED

The taxpayers entered into an agreement under which they gave a road contractor the right to remove fill dirt from their land for five cents a cubic yard. The question presented is whether the court below erred in holding that the amount received by the taxpayers for the dirt was taxable as ordinary income, rather than as capital gain.

STATEMENT

The relevant facts as found by the Tax Court (R. 15a–20a), and adopted by the court below (Pet. 1a), are as follows:

The taxpayers, Walter R. and Marguerite Laudenslager, are husband and wife. On October 1, 1945, they purchased certain lands located in Middletown Township, Monmouth County, New Jersey, together with the buildings located on them. They used the property as a residence and farm (R. 15a).

In 1952 the New Jersey Parkway Authority fixed and announced the alignment for a proposed limited access, toll highway which cut across a section of the taxpayers' property. A portion of their property was taken in condemnation by the Authority and the highway was thereafter constructed. The taxpayers' remaining property was located approximately 300 to 400 feet from the Red Bank entrance to the new highway. The contemplated construction of the highway made the area desirable for a housing development and the taxpayers' property, because of its proximity to the highway, became particularly desirable for such purposes. Real estate agents seek-

ing to interest the taxpayers in selling their property approached them even before the alignment of the new highway became definitely established (R. 15a).

George. M. Brewster & Son, Inc. (hereinafter referred to as Brewster), a road building contractor, became the successful bidder for the contract to construct the sections of the highway adjacent to the taxpayers' property. Brewster's contract with the New Jersey Highway Authority provided that it would be the responsibility of the contractor to acquire the fill required for road construction from an outside source at its own expense to complete the parkway to its final grades and elevations. Brewster, prior to submitting its bid, had determined through tests that the taxpayers' property could provide the requisite quantity and quality of earth fill. Brewster approached the taxpayers, through Emerson Branham, Brewster's resident manager, to inquire whether it could buy from them property from which the fill could be obtained, or could buy the fill itself. The taxpayers refused to sell any of their property, but agreed to permit Brewster to buy fill from certain sections of their property (R. 15a–16a). On May 1, 1953, an agreement was entered into between the taxpayers and Brewster which provided in part, as follows (Ex. 3-C; R. 9a–12a):

> WHEREAS, [Brewster] desires to purchase from the [taxpayers] earth fill to be excavated from portions of the above described premises.
>
> NOW THEREFORE, the [taxpayers] * * * hereby agree to permit [Brewster], its agents

and servants, to enter into and upon and leave from the above described premises over existing roadways with all necessary equipment therefor, and to excavate and remove from the said premises earth fill or other material therefrom in conformity with and according to the Grading Plan approved and signed by both parties hereto * * *, and [Brewster] agrees to complete the excavation and grading in accordance with the aforesaid grading Plan. * * *

Any material excavated and removed from the said property shall become the property of [Brewster] * * *.

[Brewster] agrees to pay unto the [taxpayers], the sum of Five Cents ($.05) per cubic yard for all material removed from said property. It is further understood and agreed between the parties hereto that a minimum quantity of 400,000 cubic yards is to be removed from said property and that this minimum quantity is based on the original borrow material requirements of 795,700 cubic yards as specified on the contract made between [Brewster] and the New Jersey Highway Authority-Garden State Parkway * * *.

Notwithstanding the provisions herein with respect to the minimum quantities called for under this Agreement, it is expressly understood and agreed that should the New Jersey Highway Authority reduce the original borrow material requirements on the aforesaid contract, then and in that event the minimum quantities called for herein and the total amount payable hereunder will be reduced accordingly. It is agreed by and be-

tween the parties hereto that should the aforesaid minimum quantity be decreased or increased [Brewster] will provide the [taxpayers] with a Revised Grading Plan, if requested by the [taxpayers], which Revised Grading Plan shall reflect the grades and appearances of the premises based upon such increase or decrease.

* * * all payments will be made on or about the 15th day of each month for material excavated, removed and used in the performance of the aforesaid contract during the preceding month. * * *

[Brewster] hereto advances to the [taxpayers] on account of this agreement, the sum of Five Thousand Dollars ($5,000.00) to be credited against payments due hereunder.

The borrow material being purchased under this contract is required to meet specifications provided by the New Jersey Highway Authority. It is understood and agreed that [Brewster] shall not be required to take or remove any material which does not meet such specifications and that if there shall not be sufficient quantities available which shall meet such specifications in the area involved in this contract, the [taxpayers] will allow [Brewster] to enter into and acquire further areas within which to remove suitable borrow material * * *.

It Is Agreed by and between the parties hereto that [Brewster] will remove and stockpile outside of the adjacent grading limits all top soil from any part of said premises from which material is excavated and to respread

> all or part of top soil upon the graded area, at the termination of the operation if requested by the [the taxpayers] for the sum of Twenty-five Hundred Dollars ($2,500.00) said sum to be deducted from payments due hereunder. * * *.

Attached to the May 1, 1953, agreement is a map of the taxpayers' property showing the area from which Brewster was to remove earth fill and the depth of the excavation to be made in order that Brewster might obtain the 400,000 cubic yards of fill which it originally estimated would meet its requirements. As work on the highway progressed, Brewster needed more fill than was originally estimated. The total quantity ultimately taken from the taxpayers' property, during the period from July 1953 to August 1954, was in excess of 1,000,000 cubic yards. Each time Brewster needed additional material, the taxpayer and Brewster's chief engineer went to the taxpayers' property, decided upon the area from which such material could be taken, and established an elevation down to which the material could be removed that would coincide with and match the elevation on an adjoining area from which material had already been taken. Brewster complied with the provisions of the May 1, 1953, agreement requiring it to remove and stockpile the topsoil before excavating the fill. At the taxpayers' request and in accordance with the agreement, Brewster respread the topsoil when the work of excavation had been completed, and the taxpayers paid Brewster the agreed price (R. 18a–19a).

The fill was ordinary, sandy loam, generally characteristic of the area in which the taxpayers' property was located and had no intrinsic value, by and of itself. It was the proximity of the taxpayers' property to the section of the roadway being constructed that made the property valuable as the source for obtaining fill required in the construction of the road. If Brewster had excavated more fill than it needed, it could not have sold it because there was no market for it. The taxpayers did not participate in the work of excavating the fill and did not share in any profit or income derived by Brewster from the use of the fill in the construction of the highway (R. 19a).

The area that Brewster had excavated had been used by the taxpayers for growing farm crops. After the excavation of the fill and respreading of the topsoil, the area would have required several years of rehabilitation before it could be used for growing crops. The usefulness of the taxpayers' property for housing development purposes, however, was neither impaired nor enhanced by the removal of the fill. Under an agreement dated January 27, 1954, the taxpayers sold the property, except for the buildings and land surrounding them, in accord with their intent prior to entering into the contract with Brewster (R. 19a–20a).

The Commissioner determined that the $49,309 received by the taxpayers in 1953 and 1954 from Brewster was taxable as ordinary income (R. 20a). The Tax Court (R. 21a) and the court of appeals (Pet. 1a–11a) upheld that determination.

ARGUMENT

1. Notwithstanding taxpayers' assertions (Pet. 4, 5, 7), the court of appeals formulated no novel legal test in taxing as ordinary income the amounts received by taxpayers under a contract for the excavation and removal of earth fill from their property. On the contrary, the court below applied the established rules of law to determine whether there had been a sale of capital assets resulting in capital gain or an "exploitation" of natural deposits, producing, like any other business, ordinary income. The courts, consistent with the principles laid down by this Court,[2] have distinguished two situations: (1) when mineral "in place," has been sold outright with no retention by the vendor of ownership or other "economic interest" in the deposits, the proceeds constitute capital gain (*Barker* v. *Commissioner of Internal Revenue*, 250 F. 2d 193 (C.A. 2); *Gowans* v. *Commissioner of Internal Revenue*, 246 F. 2d 448 (C.A. 9); *Dann* v. *Commissioner*, 30 T.C. 499); and (2) when the parties have made an arrangement to sell the mineral at a unit price from time to time as it is extracted from the property, the owner retaining

[2] *Stratton's Independence* v. *Howbert*, 231 U.S. 399; *Burnet* v. *Harmel*, 287 U.S. 103; *Palmer* v. *Bender*, 287 U.S. 551; *Anderson* v. *Helvering*, 310 U.S. 404; *Thomas* v. *Perkins*, 301 U.S. 655; *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599; *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25; *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308; *Parsons* v. *Smith*, 359 U.S. 215.

an "economic interest" in the deposits until physically removed, the payments are ordinary income (*Albritton v. Commissioner of Internal Revenue*, 248 F. 2d 49 (C.A. 5); *Green v. Commissioner*, 35 T.C. 1065).

2. The court below found that "the transaction between taxpayers and Brewster was simply an arrangement whereby Brewster was granted the right to excavate and remove earth fill in return for a royalty of a specified sum per unit of material taken" (Pet. App. 9a). Consequently, it concluded that the transaction did not constitute a sale "in place" of the earth fill; that, since the material was sold only as it was extracted and removed, taxpayers retained an "economic interest" in the fill prior to extraction; and that therefore the amounts received were properly taxable as ordinary income.

This conclusion is amply supported by the contract provisions. No fee interest was conveyed, since the agreement expressly stipulated that only dirt actually "excavated and removed" from the land became the property of Brewster, and monthly payments were based on the number of cubic yards of fill excavated in the preceding month (R. 16a-17a). Brewster was under no obligation to purchase a specific quantity of fill. It was not bound to extract the cross-sections of earth designated on the grading plan, whose sole purpose was to ensure that the property be left in a

condition suitable for taxpayers' future use. The purported minimum requirement of 400,000 cubic yards was subject to the conditions that this amount would continue to be required by Brewster's contract with the State and that the fill meet the State qualitative requirements (R. 17a–18a). These aspects of the transaction are strikingly inconsistent with taxpayers' contention of an outright sale "in place."

3. While the decisions of the Second and Ninth Circuits relied on by the taxpayers (Pet. 3–5) hold that there was a sale "in place," they turn upon the particular terms of the contracts. The courts in those cases construed different contract provisions as imposing an absolute obligation upon the purchaser either to take a fixed quantity of material, or to pay a fixed price irrespective of the quantity of material in fact excavated. In *Barker* v. *Commissioner of Internal Revenue*, 250 F. 2d 195, 197 (C.A. 2), in addition to a $10,000 advance deposit, the contractor was compelled to pay no less than $3,000 quarterly "regardless of the amount of material actually taken." Similarly, in *Gowans* v. *Commissioner of Internal Revenue*, 246 F. 2d 448 (C.A. 9), the court held that the owner of the land retained no economic interest in the "black sand" to be removed since the agreement provided for the removal of all the sand at a given unit price.

The question whether the decision below conflicts with *Crowell Land & Mineral Corp.* v. *Commissioner of Internal Revenue*, 242 F. 2d 864 (C.A. 5), is more difficult. There, the contract provided that the taxpayer "as *vendor* * * * *sold and conveyed* * * *

with full warranty of title, all sand and gravel underlying certain described property" (emphasis in original). *Id.* at 865. On the other hand, the contract provided for a fixed price per cubic yard, and all the sand and gravel not removed by the vendee after five years reverted to the vendor. Therefore, it appears that there was not in reality a sale of a fixed quantity of material. Nonetheless, the Fifth Circuit held that all the sand and gravel were sold, and concluded that the payment constituted capital gain. While we believe that the Fifth Circuit misconstrued the contract, if this construction is accepted, its decision is not in conflict with the decision below, since here no fixed quantity of material was sold.

The taxpayers primarily rely for a showing of conflict (Pet. 3–5) on *Linehan* v. *Commissioner of Internal Revenue*, 297 F. 2d 276 (C.A. 1). The First Circuit, while acknowledging the validity of the "economic interest" test, thought that the taxpayer there had not retained such an interest because "in every instance he sold sand and gravel for fixed prices per cubic yard without reference to the prices received or the profits, if any, made by the exploiters." *Id.* at 279. In the instant case, the Third Circuit did not agree that a fixed price was conclusive evidence of a lack of an economic interest and thought, with petitioners, that its decision placed it in conflict with *Linehan* (Pet. App. 11a, note 4).[3]

The decision in *Linehan* is not, however, in conflict

[3] We have dealt above with the similar belief of the Third Circuit that its decision conflicted with that of the Fifth Circuit in *Crowell Land and Mineral Corp., supra.*

with the actual result in this case, for the situation here differs in a very material respect not relied upon by the court below. *Lindsay*, and the other cases relied on by the taxpayers, involved the sale of a depletable asset, sand and gravel, which was entitled to a percentage depletion allowance (26 U.S.C. 613) and which was severable from the real property remaining to the taxpayer. On the other hand, common dirt is available in almost unlimited quantities and is saleable only when it is the most convenient source of borrow. Only rarely would value be separately assigned to dirt when land is acquired and its disposition (as in this case) does not normally diminish the value of the remaining land.

To qualify for capital gains treatment, the taxpayer must establish that the property disposed of constitutes a recognizable capital asset. Thus, the contract of disposition or other evidence must establish with greater precision than in the case of identifiable minerals just what it is that the taxpayer claims to have parted with.[4] Unless the owner can establish that a specific asset was conveyed, he is in essentially the same position as a licensor who has allowed the use of his property for consideration or a joint venturer who has agreed to supply fill for a construction project.

[4] This is not to say that capital gains treatment is never proper on the sale of dirt. See *Dann* v. *Commissioner*, 30 T.C. 499, where capital gains treatment was allowed on a finding that the amount of dirt required to be taken was clearly specified, the dirt was sold at a fixed price per unit taken, and the land remaining thereafter was devoid of useful value.

As we have noted, the *Linchan* case involved a depletable mineral, not dirt, and, consequently, it is not in conflict with the decision below. Nor is any other case in conflict. Indeed, as far as we have been able to ascertain, this is the only case involving dirt which has been decided by a court of appeals. We believe that the issues in this case—which involve complex and far-reaching concepts—should be thoroughly considered by other courts of appeals before review is appropriate in this Court.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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